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**Statement of
John R. Thomas
Professor of Law
Georgetown University**

**Before the
United States House of Representatives
Committee on the Judiciary**

on

“The Patent Reform Act of 2009”

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Mr. Chairman and distinguished Members of the Committee: My name is Jay Thomas. I hold the position of Professor of Law at Georgetown University, where I teach and write in the field of intellectual property law. I am grateful to have this opportunity to share my views regarding potential reforms to the law of patent damages. I testify today on my behalf, as a concerned observer of the patent system.

A number of recent trends have increased demand for greater precision in patent law's damages principles. Chief among them are increased industrial focus on the patent system, expanded efforts to derive value from patents, and the Supreme Court opinion in *eBay v. mercExchange*.¹ In view of *eBay*, courts can no longer necessarily rely on the backdrop of an injunction, coupled with private negotiation, to compensate successful plaintiff-patentees. They must generate prospective damages awards themselves.

Unfortunately, the perception is widely shared that the rules pertaining to damages are less certain than many other patent doctrines. Some observers have faulted jury reliance upon expert testimony that may lack credibility and sufficiency. Others have characterized the substantive law of patent damages as undisciplined and indefinite. The lack of a coherent standard for assessing reasonable royalties, the logical difficulties that attend such fundamental methodologies as the hypothetical negotiation, the circularity of current market-based analyses, and a leaning towards overcompensation are among the areas of concern. The result has arguably been insufficiently predictable awards that serve the purposes of the patent system poorly.²

¹547 U.S. 388 (2006).

²See Amy L. Landers, *Let the Games Begin: Incentives to Innovation in the New Economy of Intellectual Property Law*, 46 SANTA CLARA L. REV. 307 (2006).

To address these concerns, two types of patent damages reforms have been proposed before the 111th Congress. One would effectively reinforce the existing ability of accused infringers to challenge expert testimony as failing to meet prevailing standards of relevancy and reliability. The other would clarify current standards for patent damages law. In my opinion, both sorts of reforms would potentially play significant roles in bring greater predictably to patent damages law, and both deserve further consideration.

I. Proposed Evidentiary Reforms

Many observers believe that the evidence regarding damages that is placed before juries in patent trials should be subject to closer scrutiny. H.R. 1260 would introduce language into the Patent Act essentially reminding judges that “[t]he admissibility of [expert] testimony shall be governed by the rules of evidence governing expert testimony.”³ S. 515 places even greater emphasis upon the sufficiency of evidence concerning damages, requiring judges to scrutinize the “methodologies and factors” asserted by the patent proprietor prior to allowing the court or jury to consider them.⁴

These proposed reforms, while potentially valuable, appear largely to focus attention upon existing evidentiary standards. Federal Rule of Evidence 702 currently requires expert testimony to be based upon sufficient facts or data and the product of reliable principles and methods; further, these principles and methods must be applied reliably to the facts of the case. Accused infringers may file *Daubert* motions to exclude expert testimony that fails to meet standards of relevancy and reliability.⁵ Patent trial practice further allows for extensive discovery into the litigants’ theories of damages, with discovery, exchanges of expert reports, and depositions of relevant witnesses and experts. Judge Rader’s recent decision in *Cornell University v. Hewlett-Packard Co.* further demonstrates that post-verdict motions may also be used to address evidentiary shortcomings with respect to damages.⁶

Despite these standards and procedures, many innovative firms have continued to voice concerns about the state of patent damages law. As a result, amendments to the Patent Act that merely reinforce longstanding evidentiary standards may do little to promote efficiency and rationality in damages awards. Absent reforms of the substantive law that applies to the factual circumstances of individual cases, evidentiary reforms may ultimately work scant improvement to the current environment of patent damages.

In addition, inherent limitations upon the judiciary appear to render the legislature the more appropriate venue for achieving meaningful reforms to damages law. The prominent use of juries

³H.R. 1260, § 5(a).

⁴S. 515, § 4(a).

⁵*See Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993).

⁶2009 WL 1082485 (N.D.N.Y. March 30, 2009).

in patent trials,⁷ the deferential standard of review applied to their damages awards,⁸ and the limited time to state one's case on appeal do not place the Court of Appeals for the Federal Circuit or other judicial fora in an enviable position to advance the law of damages in comparison with other patent doctrines. It should be further appreciated that the Federal Circuit is bound by the Supreme Court ruling in *Aro Manufacturing Co. v. Convertible Top Replacement Co.*,⁹ a fragmented and often criticized decision regarding the basic damages principles of patent law. Awaiting judicial developments may not prove to be a rewarding tactic for resolving concerns about damages awards in patent infringement cases.

II. Proposed Substantive Reforms

Prevailing legal standards with respect to reasonable royalty determinations have been roundly criticized for their indeterminacy and logical shortcomings. Under current law, courts indulge in the legal fiction of a hypothetical licensing negotiation.¹⁰ The reasonable royalty is set to the rate a willing patent owner and willing licensee would have decided upon had they negotiated the license on the date the infringement began.¹¹ The well-known district court decision in *Georgia-Pacific Corp. v. United States Plywood Corp.*¹² identified numerous factors to be

⁷See Kimberly A. Moore, *Judges, Juries, and Patent Cases—An Empirical Peek Inside the Black Box*, 11 FED. CIR. BAR J. 209 (2001-02).

⁸See *Monsanto Co. v. Ralph*, 382 F.3d 1374, 1383 (Fed. Cir. 2004) (a jury's damages award "must be upheld unless the amount is grossly excessive or monstrous, clearly not supported by the evidence, or based only on speculation and guesswork.").

⁹377 U.S. 476 (1964).

¹⁰See *Minco, Inc. v. Combustion Eng'g, Inc.*, 95 F.3d 1109, 1119 (Fed. Cir. 1996).

¹¹See *Unisplay, S.A. v. American Elec. Sign Co.*, 69 F.3d 512, 518 (Fed. Cir. 1995).

¹²318 F.Supp. 1116 (S.D.N.Y.1970), *modified and aff'd*, 446 F.2d 295 (2d Cir. 1971). These factors include:

1. The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty.
2. The rates paid by the licensee for the use of other patents comparable to the patent in suit.
3. The nature and scope of the license, as exclusive or non-exclusive; or as restricted or non-restricted in terms of territory or with respect to whom the manufactured product may be sold.
4. The licensor's established policy and marketing program to maintain his patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly.
5. The commercial relationship between the licensor and licensee, such as, whether they are competitors in the same territory in the same line of business; or whether they are

considered in reaching a damages determination.

Experience suggests that the *Georgia-Pacific* factors are difficult to apply consistently. Although *Georgia-Pacific* provides a long list of ingredients, it offers no recipe—that is to say, no principles for deciding whether one of the seemingly randomly ordered elements should be weighed more heavily than another in a given determination. The laundry list of *Georgia Pacific* factors, many of which include several sub-components, cannot plausibly be considered to provide a “standard” for setting reasonable royalty rates at all. The result has been a potpourri of factors that experts may apply with virtually unlimited discretion.

The hypothetical negotiation framework also possesses shortcomings. In theory it focuses attention upon the desired royalty award: “an amount which a person, desiring to manufacture and sell a patented article, as a business proposition, would be willing to pay as a royalty and yet be able

inventor and promoter.

6. The effect of selling the patented specialty in promoting sales of other products of the licensee; that existing value of the invention to the licensor as a generator of sales of his non-patented items; and the extent of such derivative or convoyed sales.

7. The duration of the patent and the term of the license.

8. The established profitability of the product made under the patent; its commercial success; and its current popularity.

9. The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results.

10. The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention.

11. The extent to which the infringer has made use of the invention; and any evidence probative of the value of that use.

12. The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions.

13. The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer.

14. The opinion testimony of qualified experts.

15. The amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount which a prudent licensee-- who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention-- would have been willing to pay as a royalty and yet be able to make a reasonable profit and which amount would have been acceptable by a prudent patentee who was willing to grant a license.

to make and sell the patented article, in the market, at a reasonable profit.”¹³ Yet judicial decisions at times seems to have lost sight of the notion that a bargained-for exchange should offer benefits to both negotiating parties. The decision in *Go-Light v. Wal-Mart Stores, Inc.*¹⁴ provides one example of this troubling tendency.

In *Go-Light*, Wal-Mart was found to infringe a patent claiming a wireless, remote-controlled, portable search light. The district court awarded the patentee damages of \$31.80 per infringing unit. Although this figure was in theory based upon the reasonable royalty methodology, the district court in fact arrived at this number by awarding 50% of the patentee’s incremental profits. On appeal, Wal-Mart pointed to evidence that it typically paid 2-5% of the product’s wholesale cost as an intellectual property royalty, and that the court’s damages award left it selling the patented product at a significant loss. The court of appeals quickly dismissed these assertions, however, characterizing Wal-Mart’s assertions as “nothing more than what it might have preferred to pay”¹⁵ Affirming the damages award, the Federal Circuit cited previous holdings for the proposition that “[t]here is no rule that a royalty be no higher than the infringer’s net profit margin.”¹⁶

The hypothetical negotiation methodology further assumes that the negotiators come to the bargaining table with the assumption that the patent is not invalid and has been infringed.¹⁷ Although a judgment upholding a patent is necessarily a predicate of assessing patent damages, negotiations held at the time infringement has commenced would assuredly not proceed employing this assumption. Such bargaining would instead recognize that both patent validity and infringement may be contested by the accused infringer.¹⁸

To reasonable negotiators, the possibility of a patent been held invalid, or construed in a manner unfavorable to its proprietor, would undoubtedly result in some discount in favor of the

¹³*Panduit Corp. v. Stahl Bros. Fibre Works, Inc.*, 575 F.2d 1152, 1157-58 (6th Cir. 1977) (Markey, C.J.).

¹⁴355 F.3d 1327 (Fed. Cir. 2004).

¹⁵*Id.* at 1338.

¹⁶*Id.* (citing *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1555 (Fed. Cir. 1995) (en banc); *State Indus., Inc. v. Mor-Flo Indus., Inc.* 883 F.2d 1573, 1580 (Fed. Cir. 1989)). *See also* *Monsanto Co. v. Ralph*, 382 F.3d 1374 (Fed. Cir. 2004).

¹⁷*Rite-Hite v. Kelley*, 774 F. Supp. 1514, 1535 (E.D. Wis. 1991), *aff’d in part, vacated in part*, 56 F.3d 1538 (Fed. Cir. 1995) (en banc); *TP Orthodontics, Inc. v. Professional Positioners, Inc.*, 20 USPQ2d 1017, 1025 (E.D. Wis. 1991) (“Any negotiation is based on the assumption that the patent was valid and infringed.”), *aff’d*, 980 F.2d 743 (Fed. Cir. 1992). *See also* John J. Barnhardt, III, *Revisiting the Reasonable Royalty as a Measure of Damages for Patent Infringement*, 86 J. PAT. & TRADEMARK OFF. Soc’y 991, 1008 (2004).

¹⁸35 U.S.C. § 282 (2006).

accused infringer.¹⁹ The amount of this discount may be considerable. Although estimates of the percentage of litigated patents vary, empirical studies have suggested that approximately one-third of litigated patents—and possible an even higher percentage—are ruled to be invalid.²⁰ Notably, in some market segments the percentage of invalidated patents appears to be much higher. In Hatch-Waxman cases addressing pharmaceutical patents, for example, generic firms apparently prevail over patent holders 70% of the time.²¹ The premise that the patent is nonetheless indisputably not invalid and infringed necessarily causes the hypothetical negotiation methodology to fail to account for an essential reality of licensing negotiations that occur outside the courtroom.

For these and other reasons, damages rulings are widely viewed as unpredictable and difficult to review, but also as tending towards overcompensation to the patent proprietor. The systematic overcompensation of patent owners may interfere with the very purposes the patent system is intended to serve. Excessive damages awards effectively allow inventors to obtain proprietary interests in products they have not invented, promote patent speculation and litigation, and place unreasonable royalty burdens upon producers of high technology products. Such consequences may ultimately slow the process of technological innovation and dissemination that the patent system is intended to foster.²²

With congressional attention focused upon the patent system, bringing some order to the law of damages seems a worthwhile goal. Toward this end, H.R. 1260 proposes in part a rule that reasonable royalties should relate “only to the portion of the economic value of the infringing product or process properly attributable to the claimed invention’s specific contribution over the prior art.” There seems to be widespread acceptance of this basic position that damages should be based upon the incremental value of the invention. As explained by Chief Judge Michel:

¹⁹Edward F. Sherry & David J. Teece, *Some Economic Aspects of Intellectual Property Damages*, 573 PLI/Pat 399, 418 (1999) (“Our point here is that a ‘reasonable royalty’ for the purposes of assessing damages for past patent infringement may be significantly different (and, in particular, higher than) the actual negotiated royalty for the same patent, because the actual negotiated royalty reflects what might be termed an ‘uncertainty discount’ because of uncertainty about validity and infringement issues.”).

²⁰The precise invalidity percentage varies depending upon the time period considering in the study. See, e.g., Kimberly Moore, *Forum Shopping in Patent Cases: Does Geographic Choice Affect Innovation?*, 79 N.C. L. Rev. 889, 918 (2001) (finding a 33% invalidity rate in patent cases going to trial between 1983 and 1999); John R. Allison & Mark A. Lemely, *Empirical Evidence on the Validity of Litigated Patents*, 26 AIPLA Q.J. 85 (1998) (reporting that 46% of patents litigated to judgment are struck down); Robert P. Merges, *Commercial Success and Patent Standards: Economic Perspectives on Innovation*, 76 Cal. L. Rev. 803, 822 (1988) (citing sources reporting that the Federal Circuit invalidated 44% of litigated patents between 1982 and 1985).

²¹See *Authorized generics’ branded pharmaceuticals gain shares of generic market*, Pharmacy Choice (Oct. 2, 2005).

²²See Mark A. Lemely & Carl Shapiro, *Patent Holdup and Royalty Stacking*, 85 TEXAS L. REV. 1991 (2007).

Where the value added can be established, it should be used. Look to the market value of the product with the next best, non-infringing substitute for the component causing infringement.²³

A promising first step towards patent damages reform would be to replace the hypothetical negotiation of *Georgia Pacific* with a sensible rule that tracks real-world decision making. Faced with the choice of using a proprietary technology, a manufacturer decides what advantage would accrue through the use of that technology in comparison with the next-best alternative—including using public domain technology, designing distinct technology, or not incorporating that functionality into the adjudicated infringement at all. The difference in net values between the patented technology and next-best alternative should comprise the amount that the patent owner and infringer would share via the payment of a reasonable royalty.

III. Conclusion

A fundamental premise of the patent system is that the market most effectively assesses the worth of inventions.²⁴ As Judge Giles S. Rich explained:

[I]t is one of the legal beauties of the system that what is given by the people through their government—the patent right—is valued automatically by what is given by the patentee. His patent has value directly related to the value of his invention, as determined in the marketplace.²⁵

Far from being “automatic,” however, patent valuation has proven a complex task both for the courts and for private actors who must reach decisions based upon ambiguous doctrines. Both evidentiary and substantive reforms would potentially play valuable roles in improving damages doctrines, ultimately bringing greater rationality and predictability to the patent system.

²³Chief Judge Paul R. Michel, *A Strong Patent System*, Address to the Association of Corporate Patent Counsel (Las Croabas, Puerto Rico Jan. 28, 2009).

²⁴See e.g., Daniel J. Gifford, *How do the Social Benefits and Costs of the Patent System Stack up in Pharmaceuticals?*, 12 J. INTELL. PROP. 75 (2004) (Due to the workings of the patent system, “the extent to which they are, in fact, rewarded for their inventive activity is determined by the market.”); Nuno Pires de Carvalho, *The Primary Function of Patents*, 2001 U. ILL. J. L. TECH. & POL’Y 25 (“Patents have the primary function of serving as metering devices for society to measure an invention’s value, thus allowing patentees to stipulate competitive prices for inventions and, consequently, on the products and services that embody them”); H.I. DUTTON, *THE PATENT SYSTEM AND INVENTIVE ACTIVITY DURING THE INDUSTRIAL REVOLUTION, 1750-1852* at 26 (1984) (“Patents at least let the market decide.”).

²⁵Application of Kirk, 376 F.2d 936, 964 (CCPA 1967) (Rich, J., dissenting).